Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:VWV:RCH:TL-N-720-99
CMDRees

date: MAY 24 1999

to: Chief, Examination Division, Virginia-West Virginia District
Attn.: Jack Ferguson, Manager, Group 1116
Tyrone Hicks, Manager, Group 1115

from: CHERYL M.D. REES
Attorney

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subject: **Computation of Interest on Deficiencies In the Context of Credits Elect**

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUES

1. Whether, despite the fact that Revenue Ruling 88-98, 1988-2 C.B. 356 has not been amended, there are instances in which the District may follow the judicial decisions in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996) and Segua Corporation v. United States, (DC S.D.N.Y. June 10, 1998) in computing interest paid on deficiencies due the Service.

2. Whether the claims for abatement of interest made by

[redacted] & Consolidated Subsidiaries for their [redacted] and [redacted] taxable years fall within the clear directives of the courts in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996) and Sequa Corporation v. United States, (DC S.D.N.Y. June 10,1998).

CONCLUSIONS

1. Yes. In cases that fall strictly within the factual patterns of May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996) and Sequa Corporation v. United States, (DC S.D.N.Y. June 10, 1998) the District may follow the principles set forth therein even though Revenue Ruling 88-98, 1988-2 C.B. 356 has not yet been amended.

2. No. The decisions in May Department Stores and Sequa involved situations where no part of the credit elect was used prior to the start date of the interest computation determined by the courts. Furthermore, the start date in each case was the same for all parts of the deficiency at issue. These are not the facts presented by the [redacted]' claims.

FACTS

The facts recited herein are taken from the documents you forwarded, including letters written by the representative of the taxpayers. We have based our advise upon our understanding that you have verified those facts.

[redacted] Taxable Year

[redacted] and Consolidated Subsidiaries [hereinafter referred to as [redacted]] were calendar year taxpayers in [redacted] and [redacted]. Pursuant to a valid extension, they filed their [redacted] U.S. Corporation Income Tax Return, Form 1120, on [redacted], [redacted], reporting tax due in the amount of $[redacted]. Against that liability they had made payments totaling $[redacted] and had a credit for Federal tax on [redacted] in the amount of $[redacted]. [redacted] elected to have their refund in the amount of $[redacted] credited to their estimated tax payments for their [redacted] taxable year. They did not attach a statement to their return designating the quarter to which they wanted the overpayment applied. Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service applied the overpayment to the first installment of [redacted]' estimated tax payments for their [redacted] taxable year which had been due on [redacted], [redacted]. The following chart, prepared by the taxpayers' representative,

reflects the installment payments that were due from [redacted] for their taxable year [redacted] in order for them to avoid the addition to the tax pursuant to I.R.C. § 6655, the payments that were made and the sources of those payments:

	[redacted]	[redacted]	[redacted]	[redacted]
INSTALLMENT DUE(Form 2220)	[redacted]	[redacted]	[redacted]	[redacted]
AMOUNT PAID	[redacted]	[redacted]	[redacted]	[redacted]
OVERPAID	([redacted])		([redacted])	
UNDERPAID		[redacted]		[redacted]
OVERPAID [redacted] USED		([redacted])		
OVERPAID [redacted] USED				([redacted])
CREDIT ELECT UTILIZED		([redacted])		
UNUSED CREDIT ELECT				([redacted])

Thus, $[redacted] of the credit elect was needed in order to pay the second installment and none the of remainder of the credit elect was needed to pay any of the other three quarters.

On [redacted], [redacted], the Service assessed a deficiency in income tax against [redacted] for their [redacted] taxable year in the amount of $[redacted]. The Service also assessed interest on the deficiency in the amount of $[redacted]. In computing the interest, the Service used [redacted], [redacted] as the date on which interest began to run. The taxpayer made advanced payments of the deficiency and interest on [redacted], [redacted].

The statute of limitations for the taxpayers' [redacted] taxable year remains open under extension and examination of that year is ongoing. On [redacted], the taxpayers' representative wrote to the Service requesting that they be given a credit to their [redacted] account[1] in the amount of $[redacted] representing a reduction of the interest paid on the deficiency. She argued that this was necessary under the principles set forth in Avon Products, Inc. v. United States, 558 F.2d 342 (2nd Cir. 1978) and May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996). Under her interpretation of the two decisions, the correct start dates for deficiency interest purposes on the $[redacted] are as follows: [redacted], [redacted] on $[redacted] of the deficiency; [redacted], [redacted] on $[redacted] of the deficiency; and [redacted], [redacted] on $[redacted] of the deficiency.

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[1] They requested a credit rather than a refund because the examination is ongoing and there are issues that remain unresolved.

On [redacted], the taxpayers' representative again wrote the Service requesting an additional decrease in interest charges for their [redacted] taxable year in the amount of $[redacted] (for a total reduction of $[redacted]). Again they requested that this sum be credited to their account rather than refunded to them because of the ongoing examination. In the second letter, they argued that, applying the principles in Avon and Sequa Corporation v. United States, (DC S.D.N.Y.), No. Civ. 2086 (June 10, 1998), the correct start date for deficiency interest purposes on the $[redacted] in additional tax is as follows: [redacted], [redacted] on $[redacted]; [redacted], [redacted] on $[redacted] and [redacted], [redacted] on $[redacted].

[redacted]' [redacted] Taxable Year

Pursuant to a valid extension, [redacted] filed their U.S. Corporation Income Tax Return, Form 1120, for their [redacted] taxable year on [redacted], [redacted], reporting total tax due in the amount of $[redacted]. [redacted] had made payments against this liability in the amount of $[redacted] and claimed a credit for Federal tax on [redacted] in the amount of $[redacted]. On their return, they elected to credit their overpayment in the amount of $[redacted] to their [redacted] estimated tax payments but did not attach a statement to their return designating the quarter to which the overpayment should be applied. Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service applied the overpayment to the first installment of [redacted]' estimated tax payments for its [redacted] taxable year which had been due on April 15, [redacted]. The following chart, prepared by the taxpayers' representative, reflects the installment payments that were due from [redacted] for their taxable year [redacted] in order for them to avoid the addition to the tax pursuant to I.R.C. § 6655, the payments that were made and the sources of those payments:

	[redacted]	[redacted]	[redacted]	[redacted]
INSTALLMENT DUE(Form 2220)	[redacted]	[redacted]	[redacted]	[redacted]
AMOUNT PAID	[redacted]	[redacted]	[redacted]	[redacted]
OVERPAID			([redacted])	([redacted])
UNDERPAID	[redacted]	[redacted]		
CREDIT ELECT UTILITZED	([redacted])	([redacted])		
UNUSED CREDIT ELECT				([redacted])

On their [redacted] U.S. Corporation Income Tax Return, Form 1120, filed in September, [redacted], [redacted] claimed the entire credit elect as a payment. On that return, they reported that they were entitled to an overpayment of $[redacted]. Once again, they elected to have the overpayment credited to their estimated tax

payments for their subsequent year.

On [redacted], the Service assessed a deficiency in the amount of $[redacted] and interest on that deficiency in the amount of $[redacted] against [redacted] for its [redacted] taxable year. In computing the interest due, the Service started its running on [redacted]. It appears that [redacted] prepaid the amounts assessed.[2]

Although the chart reproduced above reflects that portions of the credit elect were needed in its first and second quarters in order to avoid an addition to the tax under the provisions of I.R.C. § 6655, in [redacted]'s representative's letter dated [redacted], she stated that, since [redacted] had already paid the first and second installments by the time it filed its [redacted] income tax return, the overpayment "is to be considered" applied to the third installment due [redacted]. Thus, they urged, pursuant to May Department Stores, interest on the subsequent deficiency adjustment should not have begun to run until [redacted]. They computed their requested abatement to be $[redacted].[3]

They did not explain the apparent discrepancy between their theories for the proposed start dates for their [redacted] and [redacted] taxable years. In their letter dated [redacted], they did clarify that, since all of the deficiency could be taken from the portion of the credit elect that was never used in any of the four quarters of [redacted], the correct start date for interest under the principles of Avon and Sequa is [redacted]. Thus, they asked for an additional abatement of interest in the amount of $[redacted] for their [redacted] taxable year for a total interest abatement for that year in the amount of $[redacted]. The statute on their [redacted] taxable year remains open under extension.

ANALYSIS

ISSUE 1

During the period from [redacted] through [redacted], the time-frame in

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[2] We are missing one page of the transcript for this year so we can not be certain that they prepaid the deficiency. We can see that they prepaid the interest that was ultimately assessed.

[3] Once again, they requested that this sum be credited to their account and not refunded due to the ongoing examination.

which the transactions herein took place, the procedures for determining the installment to which to apply a credit elect absent a designation by the taxpayer was governed by Revenue Ruling 84-58, 1984-1 C.B. 254. The procedures for determining the date on which interest would begin to run on a subsequently-determined deficiency in the year in which the overpayment that gave rise to the credit elect was claimed was governed by Revenue Ruling 88-98, 1988-2 C.B. 356.

Pursuant to Revenue 84-58, 1984-1 C.B. 254, when a taxpayer failed to designate the installment to which it wanted its credit elect applied, the Service applied its overpayment against the first installment payment of the next year's estimated tax. Revenue Ruling 88-98, 1988-2 C.B. 356 held that, when a taxpayer claims an overpayment on a return and the claimed overpayment is applied in full against an installment of the next year's estimated tax, interest on a subsequently-determined deficiency for the earlier year runs from the due date of that installment on that part of the deficiency that is equal to or less than the claimed overpayment and from the original due date on the remainder. 1988-2 C.B. 356, 357. Thus, when the Service followed Revenue Ruling 84-58 to apply a taxpayer's credit elect to its first installment payment of the next year's estimated tax, interest on a subsequently-determined deficiency for the first year began to run on the due date of the first installment payment to the extent of the amount of the credit elect.

In 1996, however, the Court of Federal Claims entered its opinion in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996). In May Department Stores, the court held that, if a taxpayer does not designate the installment to which a credit elect should be applied and the installments of estimated tax due prior to the filing of the taxpayer's prior year return were fully paid without application of the credit elect, the return overpayment will not be deemed to be credited for interest purposes to an installment due prior to the filing of the return. The court based its holding upon the "use of money" principle, reasoning that, so long as the Service had use of the taxpayer's money, the subsequently-determined deficiency was not both due ad unpaid, a requisite for the application of interest to the deficiency. See, I.R.C. § 6601(a); Avon Products, Inc. v. United States, 558 F.2d 342 (2nd Cir. 1978).

On August 4, 1997, the Service acquiesced in the May Department Store decision. May Department Stores Co. v. United States, AOD CC-1997-008. In the Action on Decision, the Service stated that, to the extent that Revenue Ruling 88-98 would require a different result than that determined in May Department Stores, the Revenue Ruling should not be followed and recommended

that Revenue Ruling 88-98 should be modified. The Revenue Ruling has not yet, however, been modified.

In the summer of 1998, the United States District Court for the Southern District of New York extended the use of money principle in Sequa Corporation v. United States, (DC S.D.N.Y.), No. Civ. 2086 (June 10, 1998). In Sequa, the district court held that since no part of the overpayment that the taxpayer elected to credit against its estimated tax payments for the following year had needed to be applied to any of the four quarters for the following year in order for the taxpayer to avoid imposition of the addition to the tax under the provisions of I.R.C. § 6655, the Service had had use of the overpayment until the unextended due date of the taxpayer's return for the following year. Thus, the court held that interest on the subsequently-determined deficiency did not begin to run until the due date of the taxpayer's return for the second year, without regard to extensions.

As a result of the May Department Stores and Sequa decisions, the Service has re-evaluated the manner in which interest on a subsequently-determined deficiency is to be computed under I.R.C. § 6601(a). The Service's present position is that, when a taxpayer elects to credit an overpayment to the following year's estimated tax liability, the overpayment is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are needed to be paid in order for the taxpayer to avoid an addition to tax for failure to pay estimated tax under the provisions of I.R.C. § 6655 with respect to the following year.

As a result of this position, to the extent the overpayment is not needed to satisfy specific installments of estimated tax for the succeeding year's estimated tax, interest on a subsequently-determined deficiency for the first year begins to run from the original unextended due date of the succeeding year's income tax return. Likewise, to the extent that the entire overpayment must be applied to one of the installments in order for the taxpayer to avoid imposition of the addition to the tax pursuant to I.R.C. § 6655, interest on a subsequently-determined deficiency will begin to run on the due date of the installment to which the credit elect was applied. Of course, in any case in which the amount of the deficiency exceeds the amount of the credit elect, the interest on the portion of the deficiency that exceeds the credit elect begins to run on the original due date of the taxpayer's return for the first year. Even though the newly-considered position has not yet been formalized by means of a modified or new Revenue Ruling, you may

follow the use of money principle employed by the courts in May Department Store and Sequa without consultation on a case by case basis.

In applying the principles set forth in the two cases, please be aware of the following:

1. Neither case dealt with a situation in which portions of the credit elect were applied to two or more installments. Thus, the question whether the Service has changed its position regarding the start date of the interest in such cases is not yet answered.

2. Transcripts and Forms 2220 must be scrutinized and evaluated in relation to the regulations under I.R.C. 6655 in order to determine when and whether the credit elect or portions thereof must be applied.

3. In large cases in which separate issues are settled at different times, each time a new issue is settled, the interest computations done previously must be re-evaluated in light of the new adjustments to the account and a view taken to the whole picture.

4. The statute of limitations must remain open at the time a taxpayer makes a request for a refund or abatement of interest.

5. Under no circumstance should the start date of interest on a subsequently-determined deficiency be a date later than the unextended due date of the taxpayer's return for its following year.

ISSUE 2

Because part of [redacted]' credit elect in each year was needed in one or two installments in order for the taxpayers to avoid an addition to the tax for failure to pay estimated taxes and portions in each year were unused, the factual context presented does not fit squarely into the factual contexts of either May Department Stores or Sequa. Therefore, we will request field service advice and apprize you of the response to our inquiry once we have received it.

If I may be of additional assistance, please contact me at (804) 771-2885.

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